McCrory Corporation Annual Report for the Year Ended January 31, 1971

McCrory Corporation—a broadly based retailing organization with 1,575 stores throughout the nation. McCrory operations are:

▼ **McCRORY-McLELLAN-GREEN,** one of the largest and most modern variety store chains in the country, with 645 stores in 38 states.

■ **S. KLEIN,** 16 full-line department stores selling fashion and staple merchandise in the New York-Philadelphia-Washington, D.C. metropolitan areas.

■ **OTASCO & ECONOMY AUTO STORES,** automotive parts and accessories, outdoor, home and recreational merchandise with 511 outlets in 13 states.

▼ **LERNER SHOPS,** the largest chain specializing in fashion apparel, with 403 stores in 39 states, Washington, D.C., Puerto Rico and the Virgin Islands.

COVER—The fashion world of S. Klein is typified in the newest S. Klein store, Cherry Hill, N.J.

McCrory Corporation Annual Report

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Annual Meeting

The Annual Meeting of Stockholders will be held in Auditorium A, The Chase Manhattan Bank, 1 Chase Manhattan Plaza, New York City, on Tuesday, May 25, 1971 at 10:30 a.m., local time. Each stockholder entitled to vote thereat will receive by mail a formal notice of meeting, together with proxy statement and form of proxy, on or about April 30, 1971, at which time proxies will be solicited by order of the Board of Directors.

McCrory Philosophy of Management

We believe in the effectiveness of the multitude—a great many normal people with normal talents working together supporting and compensating for each other.

We believe in guided autonomy - individuals using their initiative having authority to act upon it and looking to fellow executives for guidance in fields of their specialty.

We try to break our big problems into small segments and assign each to an individual who is totally dedicated to solving it.

Our operating systems and procedures are designed to provide for individual as well as corporate success. In the long run the two are inseparable.

Finally we believe in a continuous reexamination of everything we do in light of new experience. This is the only way we can maintain our progress.

Samuel Neaman
Chairman, McCrory Corporation

To Our Stockholders:

I am pleased to report that despite a very difficult year in 1970, your company achieved higher net income and earnings per share for the seventh consecutive year.

Earnings per share on a primary basis rose to $2.99 per share of common stock—up 15¢ per share from the previous year. On a fully diluted basis, per share earnings increased by 52¢ to $2.43. Our net income for the year, which includes a loss from the closed Best & Co. stores, amounted to $14,136,000, or $135,000 more than 1969. Sales from continuing operations were $908,815,000, an increase of $25,731,000 over the previous year.

It should be noted that fiscal 1970 was an unusually difficult year for many companies, a year of general economic decline coupled with sharply reduced discretionary spending at the consumer level. The bankruptcy of the nation's largest railroad, the crippling automotive strike, the collapse of major Wall Street brokerage houses, the uncertain condition of major aircraft manufacturers—each such development has shaken public confidence and, coupled with that want of confidence, has in its turn generated broader adverse effects upon the national economy. Industrial production and corporate profits declined in most sectors; unemployment increased sharply and continues to rise, and inflation accounted almost entirely for the reported increase in the 1970 gross national product.

In the face of all these difficulties, the fact that our overall results for fiscal 1970 are even better than those which made 1969 a banner year demonstrates in the most telling fashion that we have made progress in the basic management tasks which we set out to perform. We have sought constantly to build and reinforce our pool of management talent, and it is they who have now come through for all of us. We have sought to build strength upon strength, and the existence of those strengths is now amply demonstrated.

During the year we continued to expand the number of stores in operation in our fields of apparel specialty, variety stores, mass merchandising and auto-general merchandising. We opened a total of 68 new stores and continued the process of refurbishing others. We also closed 18 stores whose prospects were not favorable. Our expenditures on new stores and equipment amounted to $26 million for fiscal 1970. At the end of the year there were 1,575 stores in operation.

As I mentioned in our Interim Report for the nine months ended October 31, the Best & Co. Fifth Avenue store and the 15 branches which it had serviced were closed during the Fall period.

Along with the process of opening new stores, refurbishing others and closing unprofitable ones, goes the process of constantly reviewing and providing the merchandise stocks desired by our customers. Here, skillful use of computer-produced information and related new techniques is enabling your merchandising management to compete successfully and profitably. And management must constantly strive to be at the forefront of retailing in order that the company may continue to grow and prosper.

Among the strengths enjoyed by your company is the flow of ideas, development of personnel and improvement of technique which results from a "total retailing" organization. We have been quoted to the effect that "retailing is an industry for which a curriculum has not been written and most of the knowledge is gained through accumulated experience." We are privileged to be participating in a broad range of retailing activities that enable us to accumulate that experience in an increasingly shorter time span. We engage freely in exchanges of ideas and techniques between our operating divisions, and carry this interchange to such areas as a cross-training management development program. New ideas come from many directions and find ready and waiting proving grounds. From these ideas, and from young executives advancing through the ranks of our divisions, we believe will emerge the retailing industry of the future—an industry which indeed may be totally different from its origins, and which offers an exciting challenge not only to the new and young executives, but also to the senior personnel who are helping lead the way through this complex and changing period.

Although it appears that the general business outlook is improving somewhat, there is still a considerable degree of uncertainty for the state of the economy. Nevertheless, we believe that the continuing efforts of our fellow employees and the support and cooperation of our suppliers will enable us to continue to meet the needs of our customers and to produce for our stockholders that successful performance to which we believe you are entitled. I would like my comments to reflect a personal enthusiasm for what is happening in our company, and hope you will share that enthusiasm.

Sincerely,

S. Neaman
Chairman of the Board

April 2, 1971

McCrory Corporation
Key To Successful
Management

I. Facts

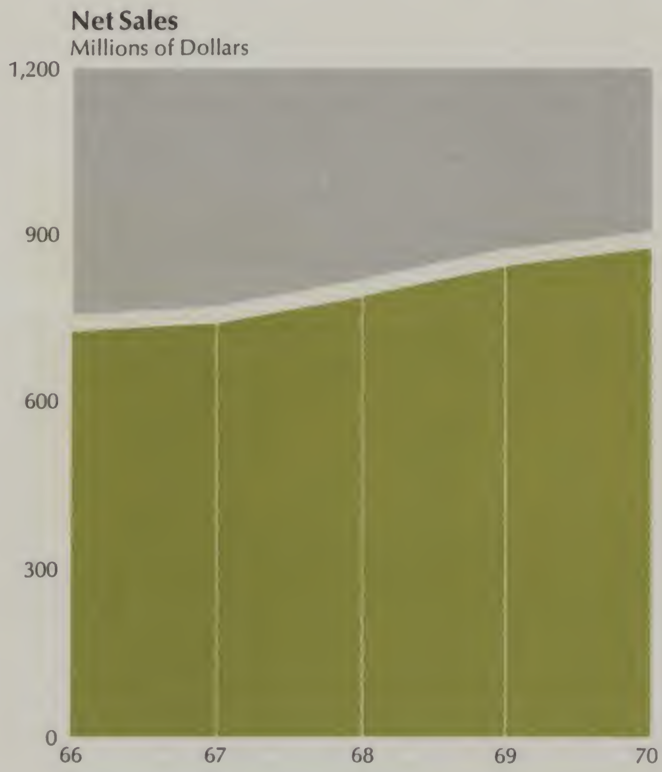
II. Plans

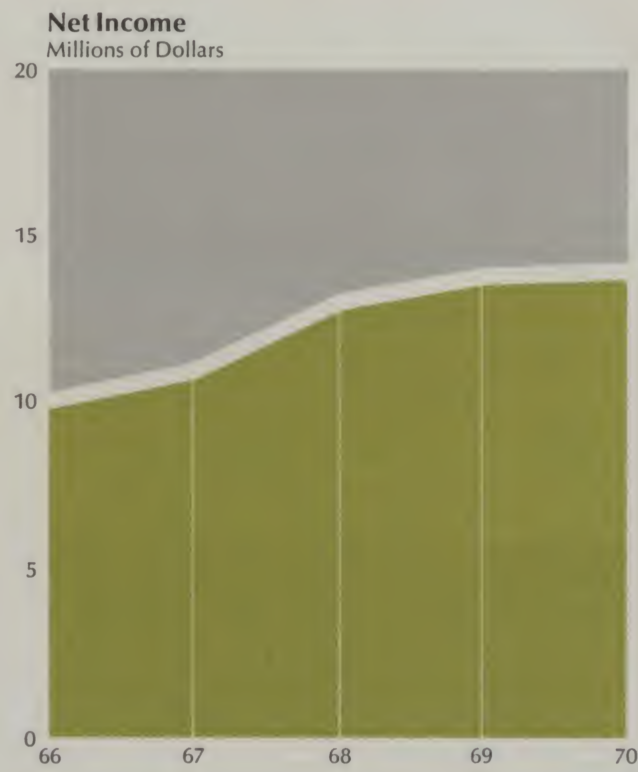
III. Execution

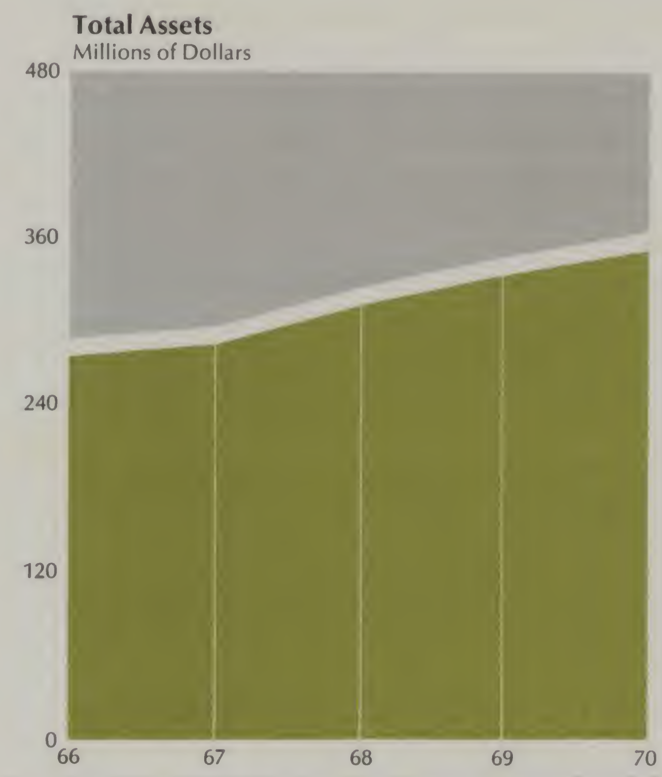
IV. Supervision

Financial Summary

	Fiscal 1970	Fiscal 1969
Sales	**$908,815,000**	$883,084,000
Net Income	**$ 14,136,000**	$ 14,001,000
Primary Earnings Per Common Share	**$2.99**	$2.84
Fully Diluted Earnings Per Common Share	**$2.43**	$1.91
Cash Dividends Per Common Share	**$1.20**	$1.20







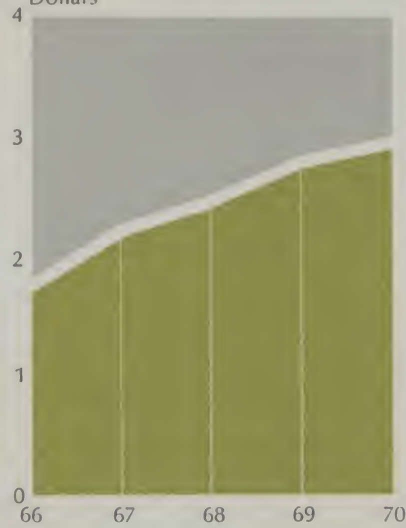
McCrory Corporation
Statistical Review

Net Sales. The McCrory organization has increased net sales in each year since 1965. In 1970 net sales from continuing operations totaled $908,815,000.

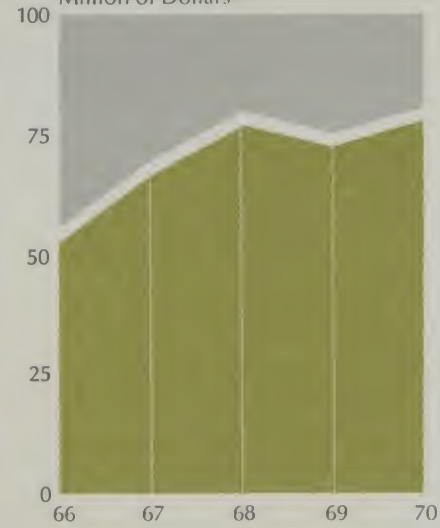
Profitability. The profitability of McCrory Corporation has progressed along with other indices of company growth. In 1970, net income was $14,136,000 compared with the preceding year's $14,001,000.

Total Assets. The total assets of McCrory Corporation again increased in 1970 to $363,691,000. This marks an increase from the preceding year of 5 per cent.

Net Income Per Share
Dollars



Working Capital
Million of Dollars



Sales

Number Store Units

Harold M. Lane, Jr.
President
Lerner Shops

F. M. Patchen
President
McCrory-McLellan-Green Stores

Julius Sanditen
Vice Chairman &
Chief Executive Officer
OTASCO & Economy Auto Stores

Stanley H. Kunsberg
President & Treasurer
McCrory Corporation

Operating Reports

McCrory-McLellan-Green Stores

OFFICERS

President
F. M. Patchen

Executive Vice President
J. F. King

Senior Vice President
T. B. Acker—National Store Operations

Vice Presidents
R. A. Elliott—Manpower
C. Gass—National Field Controller
H. R. Hughes—Administration
E. J. Leudtke—General Store Manager
P. McClellan—National Store Merchandise Manager
H. S. Mortensen—National Restaurant Manager
K. Phillips—Systems and Methods
R. S. Taub—Movement of Goods
O. W. Wheeler—Head Buyer

Vice Presidents—Regional Managers
D. Strawther—Region I
W. R. Tallman—Region II
E. B. Hood—Region III
N. W. Embley—Region IV
N. S. McBrayer—Region V

Assistant to the President
L. S. Stockley—in charge of New York Resident Buying Office

Aggressive expansion and in-depth research highlighted the beginning of a new decade for McCrory-McLellan-Green (MMG) Stores.

MMG increased profitable sales for the seventh consecutive year, enabling the division to realize pre-tax earnings in excess of $18 million. MMG's pre-tax profits, as a percentage of sales, were 6.9 per cent, maintaining the record established in 1969.

Computerized Distribution

A computerized merchandise distribution and ordering system, new to the variety store field, was ex-

Fountains and lights add to the spectacle of modern enclosed shopping malls. New McCrory stores occupy prominent suburban center locations.

panded by MMG and is currently being tested in 50 stores. The new system provides store personnel more time for selling, reduces the time lag in the distribution process, and maintains a better control of store inventory. In time, it is anticipated that the system will be expanded to all MMG stores.

The company opened 21 new or renovated units and closed 18 unprofitable stores to increase its figure to 645 stores. MMG will continue to establish new units in air conditioned malls and other high-traffic areas throughout the country.

"Highlander" Restaurant

Restaurant operations gained additional momentum with the opening of the first free-standing "Highlander" unit, which is a full line cafeteria, table service, and fast food operation, all served by a single kitchen. Long-range plans call for increased volume from food operations throughout MMG, with both in-store and free-standing units.

Training Techniques

New means of communications were opened within the division during the year through the establishment of an Audio-Visual Department using chiefly the medium of video-tape. Video-training tapes have been produced to teach the techniques of retailing, distribution, and management to MMG personnel at all levels. Home office executives are able to communicate visibly and audibly with regional personnel through video-tape. MMG is once again pioneering in an area completely new to the variety store industry.

As a result of innovations in its management and merchandising—growing out of research, expansion, and organizational flexibility—MMG strives for significant increases in sales and earnings in fiscal 1971.

The variety world of MMG includes toys and sweets among thousands of items for all ages. Computers control the flow of merchandise from automated warehouses via high-speed McCrory-owned trucks to more than 600 stores throughout the nation.

S. Klein Department Stores

OFFICERS

Chairman of the Board
Samuel Neaman

Executive Vice President
Lorence A. Silverberg

Senior Vice Presidents
Samuel S. Brand–Director of Controls
Ben Litwak–General Merchandise Manager

Vice Presidents–Group Merchandise Managers
Perry Bucholtz
Kenneth Litvack
Leonard Nacht
David Portnoy

Vice Presidents
David Ganz–Services
Charles Gass–Internal Audit
Robert Geber–Movement of Goods
Stephen Jackel–General Store Manager
Marvin Shenfeld–Systems & Methods
William M. Shuldiner
Joseph Walker–Counsel & Secretary

Controller
Charles Witz

1970 was marked by further significant strides in strengthening our systems, procedures, and controls in order to improve performance and profitability.

Sales were $190 million and pre-tax profits $1,365,000. After thorough study and analysis, the implementation of positive and effective loss prevention controls markedly reduced shrinkage losses over prior years.

Receiving of goods was further centralized, thereby facilitating distribution to stores at a lower unit cost.

Ample parking, attractive stores, great value and high style combine to make S. Klein a shopper's paradise.

Further advances were made in our sophisticated computer system which provides, quickly and effectively, the great variety of information critical to management decision-making, improved merchandising effectiveness, and cost controls.

Our new and enlarged Central Office ensures an over-all smoother flowing operation.

Expansion Continues

Continuing the company's expansion program, S. Klein opened a new major department store unit in Cherry Hill, New Jersey in August 1970, and completed arrangements for another store (its 17th) in East Brunswick, New Jersey, planned to open in 1972. It is anticipated that these stores will benefit from consumer acceptance of the company's name and reputation for merchandising dependability. During 1970 the company also continued with its modernization of the original S. Klein store on 14th Street in Manhattan, and the refurbishing of other stores.

The foregoing developments, together with continued emphasis on sound merchandising programs designed to make available to customers quality merchandise consistent with our reputation for value, should enhance the prospects of S. Klein; and we are confident that this will be reflected in future operations.

S. Klein buyers search the world for new, exciting ideas and exceptional values. The latest in home furnishings and fashion clothing are found at S. Klein.

OTASCO & Economy Auto Stores

OFFICERS

Vice Chairman & Chief Executive Officer
Julius Sanditen

Vice Chairman of Executive Committee
Ely G. Sanditen

President
Abe Brand

Executive Vice Presidents
A. A. McNatt
Edgar Sanditen

Vice Presidents
Irving Fenster–Sales Promotion
Don Mann–Store Operations
Robert Shireman–Associate Dealer Division
Ed Wilkonson–Research and Development
John Willis–Data Processing
Robert Behl–Economy Division

Secretary
Mark Colburn

Treasurer
Herman Sanditen

Completing its 52nd year of growth, OTASCO today consists of more than 500 stores stretching across 13 southwestern and southern states. The Tulsa-based organization reached an all-time high in sales of $95.8 million, an increase of over 10 per cent compared with last year. OTASCO's pre-tax earnings of more than $7,174,000 is also a record.

Distribution Enhanced

A combination of three large warehouse centers and two data processing centers facilitates the smooth distribution of merchandise to the 186 company owned stores and 325 franchised associate stores in OTASCO's growing network. Seven new stores were opened, 11 were remodelled or relocated, and 22 new dealers were added during the year.

To meet future growth, OTASCO has just completed its new 500,000 square foot Tulsa distribution center and home office building. The new center, which is among the most modern of its type in the nation, is the largest warehouse facility in the State of Oklahoma.

Along with the new headquarters and distribution center, OTASCO is completing installation of new computer facilities which will greatly increase capacity. The new distribution center, plus the computer, will expedite the distribution of information and merchandise to individual stores.

Consumers throughout the south and southwest depend upon OTASCO for home and auto needs.

OTASCO maintains a continuing program to improve personal service at the store level. Other factors in OTASCO's growth have been increased emphasis on the automotive servicing operations, modernization of service facilities, new training programs for service personnel, and incentive compensation programs.

Merchandise Expansion

Also, OTASCO has continued to expand its range of goods. Today, the chain is a general merchandiser of 300 hardgoods lines consisting of more than 8,000 individual items ranging from home electronics, housewares, and hardware to sporting goods, lawn supplies, toys, and automotive parts.

The planned expansion of both facilities and personnel contributes to our optimism for increased sales and earnings in 1971.

Lerner Shops

OFFICERS

President & Chief Executive Officer
Harold M. Lane, Jr.

Chairman of the Board & Executive Committee
Harold M. Lane, Sr.

Vice Chairman of the Executive Committee
Stanley H. Kunsberg

Executive Vice Presidents
Eugene Shaw
Karl L. Margolis

Senior Vice President & Treasurer
D. John Palladino

Senior Vice President & Secretary
Nathan B. Epstein

Senior Vice Presidents
Milton Seegal
Melvin J. Redmond
Robert L. Krill
Harold Greene
Arnold Friedman
Marc J. Reiss
David D. Greenwald

More than 50 years of service to the buying public—supplying automotive parts and service, housewares, sporting goods and hardware—has established OTASCO's reputation for quality and dependability.

Vice Presidents
Abraham D. Sperber
Monte A. Wolfson
Belle Armstrong
Anne Bergman Weltman
Betty Vitale Duncan
Tully H. Scheiner
Max J. Miller
Jacob J. Scher
Samuel S. Brand

Fiscal 1970 was the sixth successive year in which Lerner Shops achieved new records in sales and earnings. Sales increased to $354 million from last year's total of $329 million, an increase in excess of 7 per cent. Net earnings were $14.9 million, an increase of approximately 8 per cent compared with last year's $13.8 million. This continuing upward trend is the more gratifying, having occurred in a year of uncertain economic conditions, and is indicative of the fine acceptance of Lerner Shops by its millions of customers.

During the past fiscal year, Lerner Shops opened 17 new stores, all in major suburban shopping centers; one store was rebuilt and re-opened, and one store was closed. At the year end, 403 Lerner Shops were in operation throughout the country, Puerto Rico, and the Virgin Islands. Lerner Shops expects to open 22 new stores in fiscal 1971, all located in major shopping centers throughout the nation and Puerto Rico.

Modernization Policy

During the 1970 fiscal year, major improvements were completed in 32 stores and Lerner's policy of renovating and modernizing such stores as require this attention will continue during the present fiscal year.

During the past year, the final phases of the branch offices and distribution centers enlargement program were concluded with the completion of the new additions to the facilities in Denver and Los Angeles. These two branch offices, together with the ample facilities in Atlanta, Jacksonville, Chicago, and Pittsburgh, and the new New York City headquarters and distribution center, are now adequate to service Lerner's store expansion program for the foreseeable future.

Decentralization

This decentralized operation permits a more intimate supervision by each branch office of the stores within its jurisdiction, enabling those

Lerner Shops are the fashion centers for women's and children's wear throughout the country.

stores to react with greater speed to local fashion needs. When pants first became fashion's response to the uncertain length of the hemline, Lerner Shops were offering a wide array of pants dresses, pants suits, and separate pants. As knitted fabrics became more important on the fashion spectrum, Lerner Shops had knits in abundance.

Increased Appeal

Lerner Shops have always been in the forefront of every modern development which would add ease and convenience for the shopping public and create greater customer appeal. For example, the daring open-front stores in enclosed malls eliminate plate glass windows and doors to readily induce shoppers to come in and browse around. Where Lerner Shops are located in older malls which are being converted to closed malls, its store fronts are rebuilt to create the open-front effect that has proven to be so acceptable.

Assuming a favorable business climate, the outlook for the 1971 fiscal year for Lerner Shops should be most promising.

Eye-catching, outstanding displays and timely merchandise contribute to the "total fashion look" of the more than 400 Lerner shops.

Statement of Consolidated Income

	Year Ended January 31 1971	1970
Revenues:		
Sales	**$908,815,197**	$883,083,995
Other—net	**3,397,862**	3,950,603
	912,213,059	887,034,598
Costs and Expenses:		
Cost of goods sold	**656,159,362**	636,195,286
Selling, general and administrative expenses	**193,021,630**	188,224,807
Interest and debt expense	**16,476,289**	15,319,322
Depreciation and amortization	**10,744,446**	9,813,001
Federal income taxes	**15,593,000**	17,506,000
Income applicable to minority interest	**5,856,552**	5,435,669
	897,851,279	872,494,085
Income From Continuing Operations	**14,361,780**	14,540,513
Loss From Discontinued Operations—Net of Related Income Taxes	**(225,619)**	(539,279)
Net Income	**$ 14,136,161**	$ 14,001,234
Earnings Per Share of Common Stock:		
Primary:		
Income from continuing operations	**$3.04**	$2.95
Net income	**$2.99**	$2.84
Fully diluted:		
Income from continuing operations	**$2.47**	$1.98
Net income	**$2.43**	$1.91

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

Assets	January 31 1971	January 31 1970
Current Assets:		
Cash (including certificates of deposit, etc.)	**$ 19,872,118**	$ 11,949,063
Investment in Rapid-American Corporation 7% Debentures, at cost which approximates market	**3,457,295**	3,457,295
Receivables, less allowances ($3,336,894 and $2,251,426)	**9,579,732**	9,839,994
Merchandise inventories	**120,336,827**	125,355,762
Prepaid expenses, etc.	**5,376,856**	5,371,237
Total Current Assets	**158,622,828**	155,973,351
Investments in and Advances to:		
Rapid-American Corporation, at cost	**27,829,740**	27,829,740
McCrory Credit Corporation, at equity	**12,473,310**	12,250,631
	40,303,050	40,080,371
Property and Equipment	**231,988,801**	213,372,025
Less accumulated depreciation and amortization	**119,107,239**	112,085,397
	112,881,562	101,286,628
Other Assets:		
Excess of cost of investments in subsidiaries over related equities	**20,627,148**	20,627,148
Unamortized debt expense	**16,757,610**	17,853,470
Deferred stock bonus expense	**2,826,165**	3,853,720
Long-term receivable	**7,436,962**	—
Mortgages and sundry	**1,296,321**	1,555,865
Trademarks, deferred charges and unamortized goodwill	**2,939,214**	4,322,118
	51,883,420	48,212,321
	$363,690,860	$345,552,671

See Notes to Consolidated Financial Statements.

Liabilities and Stockholders' Equity	January 31 1971	1970
Current Liabilities:		
Current maturities of long-term debt	**$ 792,538**	$ 1,713,412
Accounts payable	**35,675,660**	30,688,704
Accrued expenses and sundry	**32,352,789**	32,102,521
Federal income taxes	**9,752,291**	16,343,183
Total Current Liabilities	**78,573,278**	80,847,820
Long-Term Debt, less current maturities	**130,908,562**	128,223,547
Deferred Federal Income Taxes and Other	**36,502,327**	32,043,272
6½% Convertible Subordinated Debentures	**8,329,707**	8,331,307
Stockholders' Equity:		
Minority Interest in Subsidiary	**24,182,978**	19,382,887
McCrory Corporation Stockholders:		
Preferred and preference stocks	**15,799,900**	16,551,500
Common stock, $.50 par value, authorized 15,000,000 shares; issued 7,113,955 shares and 7,090,231 shares	**3,556,977**	3,545,115
Capital surplus	**73,363,554**	72,616,835
Earned surplus	**79,985,309**	72,979,132
Less treasury common stock 2,650,926 shares and 2,697,429 shares, at cost and equity in subsidiary's cost of its treasury stock $6,797,303 and $6,806,840	**(87,511,732)**	(88,968,744)
Total Equity—McCrory Corporation	**85,194,008**	76,723,838
Total Stockholders' Equity, including minority	**109,376,986**	96,106,725
	$363,690,860	$345,552,671

See Notes to Consolidated Financial Statements.

Statement of Consolidated Surplus

	Year Ended January 31	
Earned	**1971**	1970
Balance, February 1	**$72,979,132**	$67,252,225
Add (Deduct):		
Net income	**14,136,161**	14,001,234
Dividends:		
On preferred and preference stocks	**(878,650)**	(895,922)
On common stock ($1.20 per share)	**(5,339,581)**	(5,665,958)
Excess of cost of 59,825 and 177,735 shares of treasury stock issued under stock option plans over option price	**(911,753)**	(1,712,447)
Balance, January 31	**$79,985,309**	$72,979,132

Capital		
Balance, February 1	**$72,616,835**	$53,071,182
Add (Deduct):		
Excess of principal amount of debentures and par value of preferred and preference stocks converted over par value of common stock issued	**739,894**	4,052,257
Excess of proceeds over par value of common stock issued on exercise of 345 and 796,991 warrants	**6,728**	15,541,325
Excess of cost over market value of treasury stock issued under stock bonus plans	—	(49,554)
Equity in certain transactions of subsidiary	**97**	938
Other—net	—	687
Balance, January 31	**$73,363,554**	$72,616,835

See Notes to Consolidated Financial Statements.

Statement of Consolidated Source and Application of Funds

Source of Funds	Year Ended January 31 1971	1970
Operations:		
Net income	**$14,136,161**	$14,001,234
Charges not requiring current outlays:		
Depreciation and amortization	**10,744,446**	9,813,001
Deferred Federal income taxes	**5,563,059**	3,488,000
Debt expense	**1,212,751**	1,177,827
Stock bonus plan expense	**653,125**	717,448
Income applicable to minority interest, less cash dividends of $1,081,888 and $998,183	**4,774,664**	4,437,486
	37,084,206	33,634,996
Proceeds on exercise of warrants	**11,445**	15,939,820
Proceeds on exercise of options	**925,281**	2,951,260
Increase (Decrease) in long-term debt—net (1970 exclusive of $60,000,000 of $7\frac{1}{2}\%$ debentures issued in exchange offer for shares of treasury common stock)	**2,685,015**	(13,045,312)
Long-term receivable arising from sale of lease	**(7,436,962)**	—
Cost of investments exchanged in tender offer	—	6,624,094
Other—net	**594,857**	840,808
	$33,863,842	$46,945,666

Application of Funds	1971	1970
Additions to property and equipment—net	**$22,721,592**	$24,714,340
Dividends paid	**6,218,231**	6,561,880
Funds expended in acquisition of 1,950,000 shares of treasury common stock	—	20,451,185
Increase (Decrease) in working capital	**4,924,019**	(4,781,739)
	$33,863,842	$46,945,666

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Principles of consolidation

The consolidated financial statements include all subsidiaries, except McCrory Credit Corporation.

McCrory Credit Corporation and equity in instalment accounts sold

McCrory and its affiliates assign certain customers' accounts receivable to McCrory Credit Corporation, which remits 90% of the amount thereof. The companies accept reassignment of any accounts in default, as defined. The 10% equity of McCrory and subsidiaries in assigned accounts (the uncollected balances of which amount to $52,000,000 at January 31, 1971) is included in receivables in the consolidated balance sheet. Collections in January 1971 (payable to McCrory Credit Corporation in February 1971) from assigned customers' accounts (net of 10% equity) amounting to $12,562,000 have been deducted from receivables in the consolidated balance sheet. The investment in McCrory Credit Corporation is carried at McCrory's equity in the capital and undistributed earnings at January 31, 1971 as summarized below:

Accounts receivable, less unearned discount	$59,587,449	
Cash	9,376,247	
Other assets, less other liabilities	609,614	$69,573,310
Notes payable to banks	57,100,000	
Notes payable to McCrory and subsidiaries	8,000,000	65,100,000
McCrory's equity		$ 4,473,310

Net income of McCrory Credit Corporation for the years ended January 31, 1971 and 1970 of $222,679 and $483,764, respectively, is included in consolidated income.

Merchandise inventories

Merchandise inventories, at lower of cost (mainly retail method) or market, consist of the following:

	January 31 1971	January 31 1970
Merchandise at stores and warehouses:		
At retail method	**$ 81,006,793**	$ 88,829,623
At first-in, first-out cost	**24,261,710**	23,252,754
Merchandise and raw materials in transit, at warehouses and at restaurants—at cost	**15,068,324**	13,273,385
Total	**$120,336,827**	$125,355,762

Investments

CONSOLIDATED SUBSIDIARIES:

Lerner Stores Corporation—McCrory owned at January 31, 1971 and 1970, 2,558,815 shares of Lerner common stock (60.6%).

At January 31, 1971 the aggregate cost of investments exceeded equity in underlying net assets at dates of acquisition as follows: common stock of Lerner ($8,720,000) and securities of S. Klein Department Stores, Inc. ($11,907,148). Such excess purchase costs have been recognized by the McCrory management to be similar in nature to intangibles which have not declined in value since acquisition. Accordingly, at dates of acquisition, management adopted the policy of not amortizing these excess purchase costs, so long as there is no diminution in value of the related investments.

RAPID-AMERICAN CORPORATION (parent company):

McCrory owned at January 31, 1971, 597,058 shares of Rapid-American Corporation common stock, 1,194,116 callable warrants to purchase Rapid common stock at $35 per share, expiring May 15, 1994, (said common stock and warrants had an aggregate market quotation value of $14,478,657 at January 31, 1971) and $4,985,928 principal amount of Rapid 7% subordinated debentures, due May 15, 1994 (such debentures are included in current assets in the accompanying consolidated balance sheet).

Property and equipment

Property and equipment, stated at cost, consist of the following:

	January 31 1971	January 31 1970
Furniture and fixtures and leasehold improvements	**$213,850,604**	$197,162,068
Store properties, warehouses and leased facilities	**18,138,197**	16,209,957
Total	**$231,988,801**	$213,372,025

McCrory and its subsidiaries provide for depreciation and amortization generally on the straight line method over the estimated service lives of the properties.

Long-term debt

Long-term debt at January 31, 1971 and maturities due within one year consist of the following:

	Current Maturities	Long-Term Debt
$10^1/_2$% sinking fund subordinated debentures, due August 15, 1985 (a)	—	$ 11,831,160
$5^1/_2$% sinking fund subordinated debentures, due 1976 (a) (b)	—	11,356,480
5% junior sinking fund subordinated debentures, due July 15, 1981 (c)	$ 128,829	12,344,620
Notes payable to banks under Revolving Credit Agreement (d)	—	20,300,000
$6^1/_2$% sinking fund subordinated debentures, due September 1, 1982 (e)	195,242	9,523,589
$7^1/_2$% sinking fund subordinated debentures, due May 15, 1994 (f)	—	60,000,000
Sundry	468,467	5,552,713
Total	$ 792,538	$130,908,562
$6^1/_2$% convertible subordinated debentures, due February 15, 1992 (g)	—	$ 8,329,707

(a) During the year McCrory offered all holders of its $5^1/_2$% sinking fund subordinated debentures the opportunity to exchange such debentures for an identical principal amount of the $10^1/_2$% debentures; as a result $11,831,160 of debentures were exchanged. Required annual sinking fund payments under the $10^1/_2$% debenture issue commence in 1974 at the rate of 5% of the aggregate principal amount outstanding at January 15, 1973 and continue through February 15, 1984.

(b) Exclusive of $17,321,792 reacquired which have been cancelled and are available to satisfy sinking fund payments in full. A final payment in the amount of the outstanding debentures is due on August 15, 1976.

(c) Exclusive of $130,780 held in treasury which is available for sinking fund payments. Annual sinking fund payments are 2% of the aggregate principal amount outstanding on January 15, 1970 in each year to and including 1974 and at the rate of 5% of said amount in each year thereafter to January 30, 1980.

(d) Revolving Credit Agreement: 90 day promissory notes to banks, with interest at current prime rate, renewable at the option of the Company at each maturity date to January 31, 1973. It is the Company's present intention to renew these notes until January 31, 1973.

(e) Sinking fund requirements in each year are as follows: 1971-1973 (2%), 1974-1976 (3%), 1977-1979 (4%) and 1980-1981 (5%).

(f) Required annual sinking fund payments commence in 1981 and continue through 1993.

(g) Convertible at the option of the holder at the conversion price of $25 principal amount of debentures per share of common stock to and including February 14, 1972, $30 to and including February 14, 1977 and $35 to and including February 15, 1992. During the year ended January 31, 1971, $1,600 principal amount of these debentures were converted into 64 shares of common stock.

The aggregate of long-term debt maturing during the five years ending January 31, 1976 is approximately as follows: 1972, $792,538 (included in current liabilities); 1973, $765,348; 1974, $638,541; 1975, $1,715,221 and 1976, $1,632,691. The year 1973 does not include $20,300,000 of notes payable to banks under Revolving Credit Agreement (See (d) above).

Agreements covering certain indebtedness of McCrory contain covenants concerning working capital position, additional indebtedness, limitations on the declaration and payment of dividends, restrictions on transactions in capital stock, etc. At January 31, 1971 approximately $20,000,000 of consolidated surplus was free of restrictions.

Federal income taxes

For Federal income tax purposes guideline methods of computing depreciation and the instalment method of reporting certain sales have been used. The use of these methods has resulted in tax deferrals which have been charged against income and credited to deferred Federal income taxes.

Preferred and preference stock and common stock purchase warrants

At January 31, 1971, 157,999 shares of $100 par value preferred and preference stock were outstanding (aggregate par value $15,799,900; aggregate redemption amount $17,228,851) and 30,393 shares of common stock were reserved for the conversion thereof, as follows:

Class of Stock	Shares Authorized	Shares Outstanding	Redemption Price	Conversion Rate	Common Shares Reserved
3½% preferred	2,019	2,019	104	5 for 1	10,095
$6 preference	94,725	94,725	115	3/14 for 1	20,298
5½% preference B	1,824	1,292	100	*	—
4½% preference B	60,201	59,963	100	*	—
Total		157,999			30,393

*Conversion right expired at December 31, 1970.

At January 31, 1971 there were outstanding 297,127 warrants (expiring March 15, 1976) to purchase McCrory common stock at $20 per share and 2,937,006 warrants (expiring March 15, 1981) to purchase McCrory common stock at $20 per share through March 15, 1976, and at $22.50 per share through March 15, 1981. During the year ended January 31, 1971, 7,516 shares of preferred and preference stock were converted into 23,315 shares of common stock.

Pension plans

McCrory and Lerner have non-contributory pension plans covering certain of their employees. Pension costs accrued are funded as required. For the years ended January 31, 1971 and 1970 these costs amounted to $665,000 and $662,000, respectively. No contributions were required for one plan for these years since the amounts accumulated in the trust fund exceeded the liability and vested benefits, as computed by the consulting actuary. The past service costs in respect of certain of these plans was approximately $2,342,000 at January 31, 1971, which is being amortized over a 28-year period.

Stock option and stock bonus plans

Shares of McCrory's common stock reserved for issuance under stock option plans are tabulated below:

	1960 and 1961 Plans	1964 Plan	1967 Plan
Option price range	$13.30-$21.50	$13.125-$20.125	$16.50-$32.625
Shares			
Outstanding February 1, 1970	41,150	151,730	122,521
Transactions during year ended January 31, 1971:			
Granted	—	—	8,000
Exercised	(32,300)	(25,550)	(1,975)
Cancelled, etc.	(6,950)	(54,915)	(17,450)
Outstanding January 31, 1971	1,900	71,265	111,096
At January 31, 1971:			
Exercisable	1,900	71,265	91,096
Available for grant	None	128,870	56,338

During the year ended January 31, 1971 options for 59,825 shares were exercised at an aggregate option price of $915,606 and the 1960 plan expired. In addition, 215 shares of treasury stock were issued to employees for common stock service awards.

During the year ended January 31, 1971 McCrory under its management stock bonus plans repurchased 13,537 shares and 19,777 shares are available for allocation. The excess of market value of such shares on the date of allocation over the par value thereof is being charged to income ratably over periods not exceeding eight years.

Discontinued operations

During the year ended January 31, 1971, operations of the Best & Co. division were discontinued and rights as lessee to certain real estate formerly occupied by Best were sold. The net loss arising therefrom, less related income taxes, is shown as "Loss from Discontinued Operations" in the accompanying statement of consolidated income for the year ended January 31, 1971. Accordingly, sales and costs and expenses for such year exclude the Best operations and the year ended January 31, 1970 has been correspondingly restated.

Earnings per share of common stock

Primary earnings per share is based on the weighted average number of common shares outstanding during each year. Fully diluted earnings per share have been computed assuming conversion of all convertible securities, when dilutive. This calculation also assumes the issuance of additional common shares on exercise of stock options and warrants with a portion of the proceeds used to acquire treasury shares and the balance used to reduce outstanding debt.

Other matters

There are several claims pending against McCrory and subsidiaries together with other contingencies (including long-term leases on locations at which operations have been or will be terminated). Management and counsel are of the opinion that the ultimate liability, if any, will not materially affect the consolidated financial position of McCrory and its subsidiaries. At January 31, 1971 the minimum annual rentals upon property leased to McCrory and its subsidiaries under leases expiring after January 1974 amount to approximately $40,200,000 plus, in certain instances, real estate taxes, insurance, etc.

Accountants' Opinion

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

TWO BROADWAY
NEW YORK 10004

To the Board of Directors and Stockholders of McCrory Corporation:

We have examined the financial statements of McCrory Corporation and subsidiary companies for the two years ended January 31, 1971. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have not examined the financial statements of Lerner Stores Corporation and its subsidiaries; however, we were furnished with the reports of other accountants on their examination of the financial statements of that company and its subsidiaries for the two years ended January 31, 1971.

In our opinion, based on our examination and the reports of other accountants referred to above, the accompanying consolidated balance sheets and statements of consolidated income, consolidated surplus and consolidated source and application of funds present fairly the financial position of McCrory Corporation and subsidiary companies at January 31, 1971 and 1970 and the results of their operations and the source and application of their funds for the two years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Haskins & Sells

March 19, 1971

OFFICERS

SAMUEL NEAMAN
Chairman of the Board

STANLEY H. KUNSBERG
President & Treasurer

JULIUS SANDITEN
Executive Vice President

HARRY H. WACHTEL
Executive Vice President

HAIM BERNSTEIN
Vice President

SAMUEL S. BRAND
Vice President

ELY G. SANDITEN
Vice President

SEYMOUR GREENE
Secretary

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LEONARD C. LANE
SAMUEL J. LEVY
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*BERT R. PRALL
*MESHULAM RIKLIS
*JULIUS SANDITEN
*LEONARD SPANGENBERG
JEROME D. TWOMEY
HARRY H. WACHTEL
HUGH C. WARD
J. S. WEINSTEIN

**Member of Executive Committee*

COMMITTEE CHAIRMEN

LEONARD SPANGENBERG
Executive Committee

BERNARD KOBROVSKY
Salary and Compensation Committee
and Audit Committee

HUGH C. WARD
Stock Option Committee

J. S. WEINSTEIN
Acquisition and
Diversification Committee

McCrory Corporation

AUDITORS Haskins & Sells, New York, N.Y.

GENERAL COUNSEL Rubin Wachtel Baum & Levin, New York, N.Y.

TAX ADVISORS Hanigsberg, Delson & Broser, New York, N.Y.

PUBLIC RELATIONS Rubenstein, Wolfson & Co., New York, N.Y.

TRANSFER AGENTS

Common Stock, 5½% Preference B Stock, 4½% Preference B Stock
Chemical Bank, Stockholder Relations Department,
Box 5072, Church St. Station, New York, N.Y. 10049 and
First National Bank of Chicago, Stock Transfer Division,
1 First National Plaza, Chicago, Ill. 60670

3½% Preferred Stock, $6 Preference Stock
Morgan Guaranty Trust Company of New York, Stockholder
Relations Department, 30 West Broadway, New York, N.Y. 10015
and First National Bank of Chicago, Stock Transfer Division,
1 First National Plaza, Chicago, Ill. 60670

REGISTRARS

Common Stock, 5½% Preference B Stock
Morgan Guaranty Trust Company of New York, Stockholder
Relations Department, 30 West Broadway, New York, N.Y. 10015
and Continental Illinois National Bank & Trust Co. of Chicago,
Stock Registration Department, 200 West Jackson St.,
Chicago, Ill. 60690

4½% Preference B Stock
The Chase Manhattan Bank, Transfer Administration,
1 New York Plaza, New York, N.Y. 10015 and Continental
Illinois National Bank & Trust Co. of Chicago,
Stock Registration Department, 200 West Jackson St.,
Chicago, Ill. 60690

3½% Preferred Stock, $6 Preference Stock
Chemical Bank, Stockholder Relations Department,
Box 5072, Church St. Station, New York, N.Y. 10049
and Continental Illinois National Bank & Trust Co.
of Chicago, Stock Registration Department,
200 West Jackson St., Chicago, Ill. 60690

EXECUTIVE OFFICES 360 Park Avenue South, New York, N.Y. 10010

McCrory Corporation 360 Park Avenue South, New York, N.Y. 10010